"You have to see all this risk gone before you can get back in the market."

Marcus Padley, 17 June 2012

"I think, honestly, if you're not willing to be invested in shares now you should probably set the long term goal that you shouldn't be in shares ever."

Matt Ryan, 20 June 2012

A chorus of media commentators, including Marcus Padley (quoted above), are currently warning that the only place to be invested in these turbulent times is in cash. Here's how Padley described the equity markets on the ABC's *Inside Business* in mid June.

"There's an absolute tempest going on out there and to sit in a boat in the middle of it when you can stand on the shore is ridiculous."

Now this sounds like mighty frightening stuff doesn't it?

But compare this to the same Marcus Padley in April 2007, just seven months before the market reached its all time peak.

*"Forget Greenspan's mountain of credit, forget the sniff of fear. ... **On what is in front of us now all Australians should be fully invested**, fully up to weight in resources and making the most of it."*[*]

Two months later, in June 2007, contemplating a portfolio of Australian shares that mum and dad investors could safely hold over a period of 10 years, Marcus Padley nominated BHP Billiton, Rio, Fortescue, Gindalbie Metals, Woodside, Worley Parsons, Boart Longyear, Leighton, Downer EDI, United Group, Macquarie Bank, Babcock & Brown, ANZ, AXA, Perpetual, AMP, ASX, Westfield Group, PBL, Cochlear and Computershare. We are now half way through that decade-long timeframe and Padley's "set and forget

[*] By contrast here is a summation of our take on the markets at that time:

"In the current rosy economic environment it is easy to believe that things will always continue as they are – a high level of employment, low inflation, rising company profits, buoyant property values and a soaring share market. Yet just a few years ago we couldn't see beyond the fact that we were on the brink of war, people were flying aeroplanes into buildings, the bird flu and SARS were unleashed, corporate standards had collapsed and we were engaged in an ongoing war on terror. The world seemed to be coming to an end. In truth both views of the world are wildly awry. It is both less perfect and more resilient than we imagine at times.

"When investing it is important to block out the external noise as much as possible and focus on the fundamental qualities of the individual business you are buying a share of. This requires a conscious effort as our natural inclination is to move with the crowd..."

portfolio" has lost 42% of its value. As Warren Buffett once observed, "You pay a high price for a cheery consensus."

What the disciples of cash also seem to ignore is that any slowdown in the Australian economy – particularly one sparked by a decline in demand for our resources – will more than likely be accompanied by an equally steep decline in the value of the Australian dollar. By taking money out of equities and putting it in Australian cash deposits you are not so much standing on the shore as on a floating pontoon. We hope, and expect, to be ultimately rewarded for having steadily bought assets over the past couple of years that are either denominated in, or get a large part of their earnings in, currencies other than the Australian dollar.

I think there is a basic misconception about what is meant by "risk". I think most investors see it as the chance of incurring a loss on their investment. But market economists and financial commentators see it as the extent to which the price of an asset moves relative to the market. They even have a Greek letter, β (beta), to describe this relationship. But movement in prices is "volatility", not "risk". Historical volatility has been appropriated by market economists as a proxy for risk because it can be **measured**, unlike risk which is forward looking. It can therefore be expressed as a number and plugged into the economist's equations.[†]

Having said all this, our current levels of cash are the highest I can recall which is a situation I am very comfortable with. Not because cash is a good investment. It's not; it is generally an appalling one as its value inevitably erodes over time. But it affords optionality and enables you to pounce on opportunities when they present themselves, as they have been doing in this **volatile** (rather than "risky") market. There is little value in holding large amounts of cash unless you are prepared to use it to take advantage of stupid prices when the market presents them.

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[†] Warren Buffett offered sage advice on how to value a security when he said, "Read Ben Graham and Phil Fisher, read annual reports, but don't do equations with Greek letters in them."